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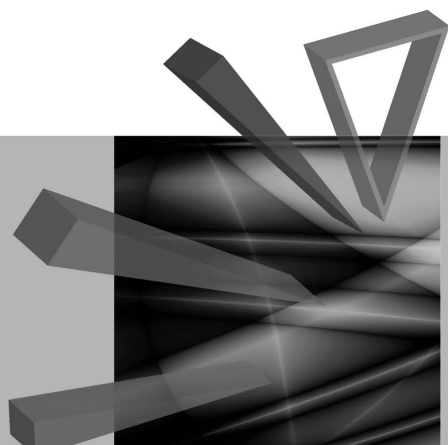
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Dziś i jutro polityki spójności w Unii Europejskiej



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ECONOMIC TRENDS ANALYSIS OF LATVIA IN EU COHESION POLICY CONDITIONS

Summary: The article deals with tendencies in the social-economic structure of Latvia after its joining the European Union. The problems that arise after the change of economic system and Latvia's accession to the EU are analysed: the demographic situation, economic crisis, the stratification of society, the expansion of the state apparatus, rapid impoverishment of the population and, consequently, high rates of emigration to the more affluent EU countries. The article discusses the role of Cohesion Policy in the economic development of Latvia after its joining the EU, and for a period up to 2013.

Keywords: Latvia's economy, social-economic structure, Cohesion Policy.

1. Introduction

Since Latvia regained its independence, it has undergone significant changes in its economy: from planned socialist economy to the market economy. After the disintegration of the Soviet Union, Latvia inherited rather good-qualitative material infrastructure (roads, ports, pipelines, power facilities) and relatively educated labour force that could provide it with effective adaptation to new market conditions. At the same time, becoming independent, Latvia lost its huge internal Soviet market, which fell a hundred times at once. After the independence restoration the structure of Latvian economy began to change dramatically: there was a decline in the share of industry growth with a corresponding share of services. Initially, the reason for this change in the economy structure was associated with the realization of Latvian Popular Front economic situations program, whose purpose was to reduce the number of jobs held by non-indigenous population in existing industrial facilities. Then, this trend continued through the policy of "open door" to foreign investment, leading to the excessive growth of financial intermediation and real estate transactions.

A landmark moment in this direction can be considered as the entry of Latvia into the EU and Cohesion Policy conducted within the limits of this union – the alignment of social and economic disparities among countries in the region.

The main purpose of the research is – based on the analysis of economic situation in Latvia – to reveal trends of its economic policy further development in modern conditions of EU Cohesion Policy. The task of the research is:

1. To reveal the main reasons for changing the structure of Latvia's economy after the collapse of old command-economic system and independence finding.
2. To make a brief analysis of trends in major sectors of Latvian economy.
3. To analyze the process of cohesion development during the period since 2007.
4. To reveal the challenges facing Latvia in developing its economic potential and ways to overcome them.

The subject of the research is problems of the Latvia's national economy structure development in terms of its membership in the EU. Research methodology includes conducted studies based on the methodology of systems analysis, involving the structural-functional approach of allocating system objects in the structural elements and define their roles (functions) in the system. At the heart of the scientific research we also used a process approach to the analysis of development trends in the economic infrastructure of Latvia in the FSU territory.

2. The economy of Latvia – basic characteristics

At the moment of Latvia's joining the EU in 2004, Latvia's industry constituted 25% of the total national economy of Latvia, the services – about 70% and agriculture – 5%. The industry basis was constituted by such industries as the food, textile and woodworking industry, although the reports of all three Baltic countries at the EU entry were built under the search of high-tech development capabilities [1].

Nevertheless, by EU classification the three Baltic countries in 2004 were attributed to the group “Regions in a state of economic transition”, characterized by a deep restructuring of the economic structure, high unemployment and low GDP [2].

Many states, especially in transitional economy conditions are faced with the objective necessity to stimulate investment activity. Foreign investments lead to real production growth, modernization, infrastructure development, national banking system strengthening or, in extreme cases, go to the development of national production goods consumption. This means that there are new tools of a competitive product mass creation with high added value. Unfortunately, not industrial production, but a financial intermediation and real estate transactions became the basic industry of Latvian economy, where foreign capital has invested as a result of the state policy supporting.

Thus, if in 2000 the economy basis of Latvia consisted of agriculture and industry, and they provided 30.1% (9% + 21.1%) of value added in Latvia, they em-

employed 36.3% (18.3% 18%) working in the country, in 2008 the share of value added in agriculture and industry decreased to 14% (3.1% + 10.9%) and there were employed 22.8% (7.9% + 14.9%) of all workers.

The rate of decline in the share of industry and agriculture in GDP in Latvia was the highest in Europe. Primary development in the country was caused by services, which amounted to 77% of GDP in 2009.

Thus, the following services, were inherently provided mainly to the residents of Latvia: trade, transportation, finance, real estate, education, health, public administration and defense. Of course, part of the services – hotels, transportation, transit, finance – concern export, but they cannot fully compensate for the losses from the downturn in agriculture and industry. Trade was the leading branch of economy in 2010 – it produced the greatest added value and the largest number of employees worked there. It was despite the fact that the share of local capital in the retail trade of Latvia took a little over 30%. The rest of the market was occupied by large retail networks from Lithuania and Scandinavia.

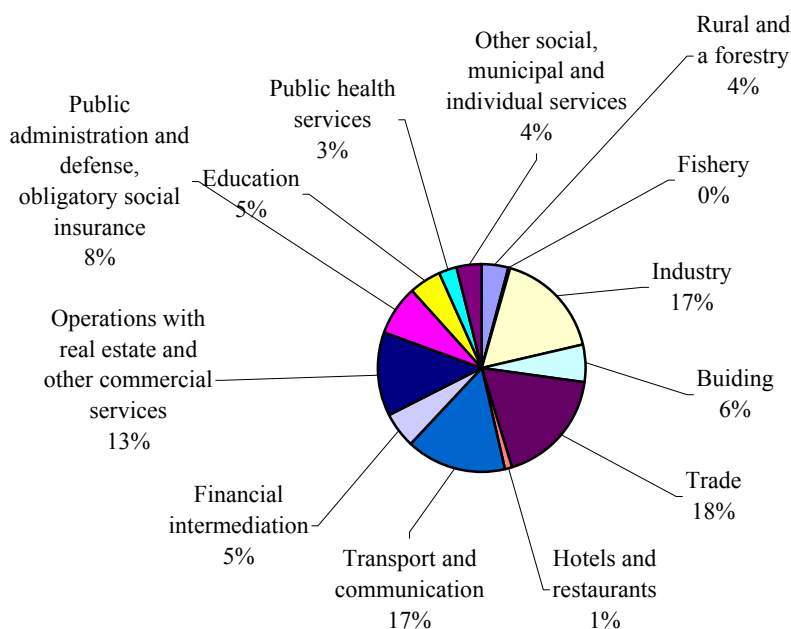


Figure 1. GDP structure of Latvia in 2010

Source: Statistical Yearbook of Latvia, <http://www.csb.lv>.

Foreign trade structure has not undergone significant changes since 2004. The largest item of Latvian export for all these years is wood. It is despite the fact that the proportion of local economy in the economic structure of Latvia is so small

that, together with agriculture, it declares when the total figure constitutes 4.2% of GDP. Wood is about one third of Latvia's export, textiles (the second place) – 14% of total export and metal (the third place) – 13%. Import predominates over export. The largest percentage of export in Latvia accounted for machinery and equipment – 21%, followed by fuel and energy resources.

Regarding agriculture, there was a trend towards a reduction of its share in the economic structure of the country, particularly reinforced by the so-called restitution, when a lot of pieces of land were returned to people who were not interested in cultivating or did not have possibilities to do it. Sown area was reduced from 1.5 million hectares in 1990 to 0.9 million hectares in 2004. As a result, the rate of funds for agricultural land remains only 27%.

Now the economic structure of Latvia looks like as follows: agriculture and forestry – 4.2%, industry – 17.19%, service sector – 78.7% [3]. Sectoral structure of GDP in Latvia is shown in Figure 1.

Taking into account that Latvia is a small country, without deposits of raw materials and energy which it has to import, with a limited domestic market, it is necessary to admit that it cannot develop effectively, being able to increase continuously only its services. Therefore, in general, the country has developed irrational economic structure, which will no longer be able to provide self-development.

3. Forecast for Latvia's economy

Unfortunately, the irrationality is present also in the structure, which is urged to manage the state economy. The Latvian "state machine" is one of the largest among all European countries with a share of officials constituting as much as 8.2% of the total economically active population (in comparison, in neighboring Lithuania only 0.93%), and the cost of maintaining the state apparatus is 20% of the state budget (in Estonia only 8%). At the same time, on the general background of cuts in salaries of the social sector employees in order to consolidate the budget, salaries of officials remain intact and even grow.

At the same time, according to Eurostat, Latvian GDP *per capita* is almost half below the European average and six times lower than the richest EU regions. If we take the European average as 100%, the nominal level of wealth in Latvia (purchasing capacity of the population) is 56% of the EU (Lithuania – 61%, Estonia – 68%) [4].

According to forecasts of the British magazine "The Economist", in 2012 by the index of purchasing power parity (PPP) *per capita*, Latvia would be at the level of Malaysia, Libya, Uruguay and Turkey. According to Eurostat, using this indicator, Latvia has been ranked 24th in Europe for a long time, sharing the place with Poland. In the so-called "fat years" Latvia was able to pull ahead a bit, but after the economic crisis beginning in 2009 it has returned on a former place. At present, only Romania and Bulgaria remain poorer in the EU than Latvia. The index of Lat-

vian purchasing power parity in 2011 *per capita* constituted 14.940 dollars (in comparison in Lithuania 17.370 dollars, and in Estonia 18.970 dollars) [5].

4. Latvia and the EU Cohesion Policy

Latvia with all its regions falls in 99 EU items that need help. It is known that funding for the alignment (Cohesion) in 2007-2013 constitutes more than 30 percent of the total EU budget, which is more than 50 billion euro per year. Overall, the alignment of social and economic inequalities is planned to allocate over 313 billion euro in the period 2007-2013. The objects of assistance are primarily countries of the European Union newcomers, as well as certain regions of Greece, Portugal, Spain and Italy.

As regards Latvia, the funds allocated to it from the EU structural funds, amounted to 3.17 billion *lats*, i.e. about 4.5 billion euro (Figure 2).

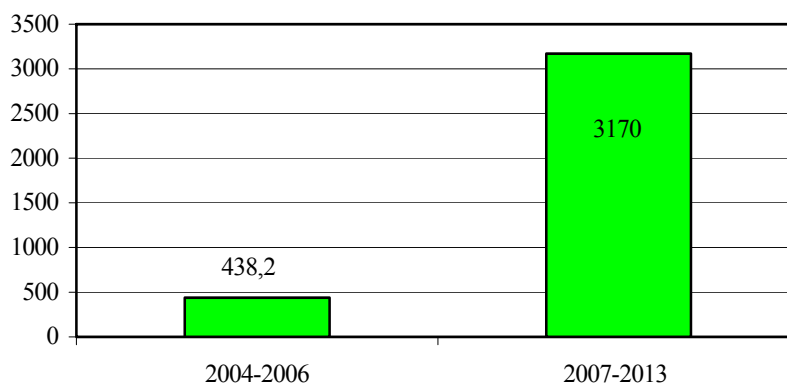


Figure 2. Funds allocated for Latvia from the EU structural funds, million *lats*

Source: Eiropas reģionālās attīstības fonds (EPAF), www.esfondi.lv.

Thanks to the alignment program, Latvia implemented a series of major investments in transport infrastructure and facilities to protect the environment. Among them there were modernization of water supply systems in large municipalities (11 projects), construction of debris processing facilities (10 projects), development of road and transport infrastructure (12 projects). Among the latter ones there are such major projects as *Via Baltica* highway, the access roads to the airport Riga and the largest Latvian ports.

In general, if we talk about infrastructure objects, in 2010 Latvia was the only country whose projects in the field of means development from the Cohesion Fund for the next three years were adopted in full by the European Commission. It means that shortly there will be implemented 7 more major investment projects: the construction of two road sections duplicating route Riga – Moscow (total budget of over 150 million *lats*) and a lining of the second railway track on the stretch Skriveri – Krustpils (budget about 65 million *lats*).

Also with the help of European funds it is planned to modernize the system of passenger rail transport in Riga (144 million *lats*), clean up tar ponds in the vicinity of Inchukalns (20.3 million *lats*), move the port infrastructure of Riga to/from free port on Russian Island (54 million *lats*) and perform other equally ambitious plans.

If we talk about other areas of assistance using the means of European funds in Latvia, there is for example a program of subsidized jobs, retraining courses and training for the unemployed or people just under threat of dismissal. Also in the country there are different programs to support entrepreneurship, concerning both the provision of loan funds for business development, and partially to cover the cost of production modernization, new markets and so on.



Figure 3. Funding distribution among programs in 2007-2013 (%)

Source: Eiropas reģionālas...

The total assistance for Latvia allocated in this period reached 3.17 billion *lats*.

At present, Latvia receives most of the funding part from EU structural funds in the frameworks of the cohesion policy. Moreover, many areas in the country actually exist due to the support of European funds.

The total assistance for 2010 amounted to 485.5 million *lats*.

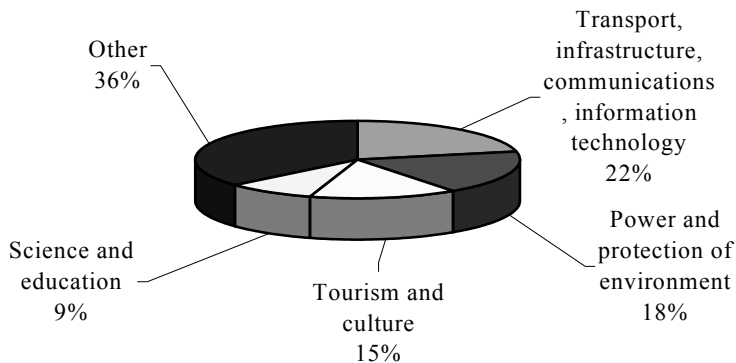


Figure 4. Funding under the equalization policy on areas of national economy of Latvia (million *lats*)

Source: Eiropas reģionālas...

Despite the fact that in recent years Latvia has rather succeeded in the business of European money development (both in terms of volume and speed of writing applications), it has been also criticized.

In mid-November the country was visited by Alan Roger, the representative of the Directorate General for Regional Policy of the European Commission. He pointed out that the alignment program has not leveled economic and social situation of people from different regions of Latvia. “The size of GDP per inhabitant of Riga exceeds the average in the EU, whereas the same figures in Latgale is three to four times lower than European standards!” – said Roger.

This outrageous fact suggests that till now the work of equalization program has not met its primary task to reverse the dramatic differences in living standards. Therefore, the next tranche of financial resources distribution will be under new rules that will ensure greater effectiveness of funds spent on the poorest regions development.

It should be noted that for Latvia as a whole, this situation is unprofitable because it automatically implies a decline funding. In that case, if we consider only one region of Latvia, but not all parts of the state, Latvia will have fewer opportunities to improve the welfare of Latvian residents as a whole.

In November 2011 the European Commission launched extensive consultations in all EU countries, including Latvia, on the future Cohesion Policy in the period 2014-2020.

The main offer of the Commission is active participation in joint international projects that have big purposes in front. For example, it is offered to support and strengthen cooperation both between regions in one country and in the region of the Baltic Sea.

Another general line of the next alignment phase is to direct funding to the social sphere and population employment.

5. Conclusions

Summarizing all data cited above, one should note that they were based on Government Information, Statistics Department of Latvia, claims to be a high degree of reliability and performance analysis of the Latvian National Development Project under the European strategy “Europe 2020”. All this suggests that the current economic situation of the Latvian market creates great difficulties for the positive development of Latvia’s economy now and in the short term [6].

For further country development it is necessary to develop a clear vision of the country to identify priority sectors which will build the economy of Latvia. The government’s strategy aimed at survival by consolidation of the budget through reductions and cuts, must give way to thinking, focused on the future development. There is a necessity of state development strategy based on public investment in social infrastructure and human resources as a prerequisite for long-term socio-economic development of Latvia.

Currently, Latvia cannot do without the financial assistance of EU funds. However, if in the future these funds are not spent on job creation in priority sectors of the economy but on the maintenance of large state bureaucracy, Latvia risks losing the final of its main wealth – human potential, becoming the backyard of the European Union and definitely losing its economic and then political independence, as a state bankrupt.

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ANALIZA TENDENCJI W GOSPODARCE ŁOTWY W WARUNKACH POLITYKI SPÓJNOŚCI UNII EUROPEJSKIEJ

Streszczenie: Artykuł dotyczy tendencji występujących w sytuacji społeczno-ekonomicznej Łotwy w okresie ostatnich 10 lat po wejściu do Unii Europejskiej. Analizowane w artykule problemy pojawiły się w związku ze zmianą systemu gospodarczego Łotwy i jej wejściem do UE. Są to: problemy demograficzne, kryzys ekonomiczny, rozwarstwienie społeczeństwa, ekspansja administracji państwowej, gwałtowne ubożenie społeczeństwa oraz w konsekwencji wysoki współczynnik migracji do bogatszych krajów UE. W artykule omawiana jest rola polityki spójności w rozwoju społeczno-ekonomicznym Łotwy – od jej wejścia do UE do 2013 roku.

Słowa kluczowe: gospodarka Łotwy, uwarunkowania społeczno-ekonomiczne, polityka spójności UE.